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BEFORE THE UNITED STATES
POSTAL REGULATORY COMMISSION

Transfer of Bound Printed Matter Parcels to the Competitive Product List	Docket No. MC2021-78

COMMENTS OF SCHOLASTIC, INC. OPPOSING THE TRANSFER OF BOUND PRINTED MATTER PARCELS TO THE COMPETITIVE PRODUCT LIST (May 17, 2021)

Pursuant to Order No. 5856 and Order No. 5880, Scholastic, Inc. ("Scholastic"), files these comments opposing the March 26, 2021 request of the United States Postal Service ("Postal Service" or USPS) pursuant to 39 U.S.C. § 3642 and 39 C.F.R. § 3040.130 *et seq*., that Bound Printed Matter ("BPM") Parcels be transferred from the Market Dominant product list to the Competitive product list.[1] The requested product transfer is contrary to the governing statute, is not factually supported, and would cause significant harm to Scholastic and to its customers, educators and their students of modest means, who rely on obtaining Scholastic's books and other educational materials at affordable prices. Scholastic respectfully submits that the Request must be denied in its entirety. At a minimum, the Commission should find that the Postal Service has failed to justify the transfer of multi-component educational bundles, a subproduct within BPM Parcels.

I. INTRODUCTION AND SUMMARY OF POSITION

The Postal Service requests the transfer of BPM Parcels to the competitive product list as a subcategory of Parcel Select called Parcel Select Bound Printed Matter. *See* Request, at 1. The Postal Service also "seeks authority from the Commission to implement a price increase under the competitive

[1] United States Postal Service Request to Transfer Bound Printed Matter Parcels to the Competitive Product List (Mar. 26, 2021)("Request").

rules for the category simultaneous with the transfer." *Id*., at 18. The Postal Service acknowledges that its customers, of whom Scholastic is one, will likely have "major concerns" as to the "effect of the transfer on prices, and, in particular, the fact that prices will no longer be subject to the inflation-based Market Dominant ratemaking system." *Id*., at 14.

The Postal Service brushes off these customer concerns by asserting that the "mailers of BPM Parcels are overwhelmingly highly sophisticated commercial entities that have alternatives for the delivery of their parcels." *Id*., at 14. Whomever the Postal Service may have in mind with this statement, Scholastic has no such reasonable alternatives. The Postal Service has failed to prove there is effective competition for BPM Parcels. As discussed below, Scholastic's mailing costs would increase substantially for both the book orders it fulfills using BPM Parcels and for Scholastic's educational, multi-component bundle BPM Parcels. The corollary to this fact is plain -- the Postal Service could substantially increase its prices for BPM Parcels and Scholastic would have no alternative but to pay these dramatically increased costs.

For over 100 years, the Postal Service has helped Scholastic achieve its mission of helping children unlock their potential through reading by providing access to affordable books and educational content to every student regardless of economic or social background. The Postal Service delivers millions of classroom magazines and Scholastic Book Club Kits annually to schools across America, including schools in remote and rural areas of the country. Scholastic also uses BPM Parcels to fulfill its book orders. These mailings create reading choices for children and help to build free classroom libraries, improving literacy and educational outcomes.

Student and classroom magazines are shipped individually or as FIRM bundles. Multiple Scholastic Book Club Kits are bundled and shipped together to schools as a single BPM Parcel, the makeup of which is different from other Bound Printed Matter Parcels. These educational multi-component bundles are shrink wrapped and strapped and remain intact through Postal Service processing and delivery until they are opened at their destinating school, at which point the individual Book Club flyers and related materials are distributed to teachers and students.

Given the substantial volume of bundled flat-shaped mail that it processes, the Postal Service is uniquely suited to handling the educational multi-component bundle BPM Parcels shipped by Scholastic. In fact, private carriers have communicated to Scholastic their unwillingness to process and deliver comparable educational multi-component bundles. Private carriers have stated they would only accept containerized shipments. The cost to Scholastic to retool its operations and to ship these materials in cardboard boxes would be prohibitive.

Scholastic disagrees that the BPM Parcel product in general meets the definition of a competitive product because as shown below there is no effective competition from other firms offering similar products. Scholastic is certain that there is no effective competition for the educational multi-component bundles subproduct of BPM Parcels. The Postal Service exercises sufficient market power such that it can raise prices significantly for BPM Parcels without risk of lost business because there are no other firms offering a comparable product. If the Postal Service raised the prices it charges Scholastic significantly, Scholastic would have to pay the higher prices or reduce its mail volume, thus jeopardizing its educational mission.

This dramatic increase would hurt not only Scholastic itself but the millions of educators and students who rely on Scholastic's products. Many hundreds of them have provided comments in the record attesting to this fact. A typical example reads as follows:

> I know this will dramatically increase the rates for flyers and books that are mailed to schools.
>
> I teach Kindergarten in Vanceburg, KY, and there is no doubt that the additional costs will ultimately be passed on to those purchasing books—students and their families. There are already too many barriers to reading for most families I work with. I depend on access to affordable books, which the bound printed matter rates provide, to help me close the gap for my lower-income students who normally could not afford higher-priced books.

> Typically, more than 80% of my students come from families that don't have the means to create home libraries for their children. As a Scholastic Book Clubs partner, I am able to earn and use Bonus Points to build a classroom library of books for my students. I also use low-cost but high-quality books as rewards in my class for children who would 2 otherwise never have a new book of their own.
> These books, both in the classroom and at home, continue to inspire a love of reading in my students, which has a positive impact on their success in all areas of life.
>
> The pandemic has already had a tremendously negative consequence on my students' learning experience and literacy rates in the United States. The increase in mailing costs of educational materials will make access to children's literature even more difficult. I urge you to deny this transfer, or to exempt educational materials, so that I can continue to provide access to affordable, quality books for my students and families. The impact of this change for our school children would be too high a cost to bear.

Comment of A. Gray, submitted April 28, 2021.

The Postal Service has not met its burden to show that it is entitled to the transfer it seeks. It has admitted in its answers to information requests that it exercises market power and would be able to increase prices if its transfer request were granted. It has not done any of the analyses that would be necessary to support its contention that customers such as Scholastic have reasonable alternatives to BPM Parcels. And it misconstrues the statute as permitting it to impose substantial price increases upon such transfer based on its assertion that it is undercharging now. Perhaps recognizing the deficiency of its Request, the Postal Service repeatedly states that this is the fifth in a series of product transfer requests. But inertia is not a sufficient basis for the Commission to approve the request. BPM Parcels are unique in many respects from prior product transfer cases and each product must be evaluated on its own merits under the statutory and regulatory product transfer rules. For all these reasons the Commission should deny the transfer request.

II. DISCUSSION

A. Under Section 3642 BPM Parcels Must Be Considered a Market-Dominant Product Because the Postal Service has the Ability to Exercise Market Power over the Product

1. The Postal Service cannot meet its burden to show it lacks market power

The Commission has recognized that the Postal Service bears the burden of proof to support its request. *See, e.g., Competitive Product List Adding Round-Trip Mailer*, Docket No. MC2013-57, CP2013-75. Order No. 2306 at 2-3 (Dec. 23, 2014)(denying transfer request where the Postal Service "failed to demonstrate that the alleged forms of competition upon which it relies prevent it from exercising sufficient market power" under the statutory standard set out in 39 U.S.C. § 3642(b)(1)). This is generally true of any proponent of an agency order. *See* 5 USC 556(d)("Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof.").

Section 3642(b)(1) requires that products over which the Postal Service "exercises sufficient market power" must remain on the market dominant product list. 39 U.S.C. § 3642(b)(1). The statute defines "market power" as follows:

> the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, *or* decrease output, without risk of losing a significant level of business to other firms offering similar products

Id. (emphasis added). The statutory definition is clear and controlling. It is also consistent with market power as it is defined in antitrust case law -- the power to raise price or control output. *See, e.g., Jefferson Parish Hosp. Dist. No. 2, v. Hyde*, 466 U.S. 2, 27 n.46 ("market power exists whenever prices can be raised above the levels that would be charged in a competitive market"); *Cogan v. Harford Mem'l Hosp.*, 843 F. Supp. 1013, 1020 (D. Md. 1994)(market power "means the power to injure consumers by curtailing output and raising prices"). *See also* William M. Landes & Richard A.

Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 939 (1981) ("A simple economic meaning of the term 'market power' is the ability to set price above marginal cost.").

The Postal Service does not dispute that it exercises market power; to the contrary it concedes the point, stating "[t]he Postal Service did not, and does not, maintain, that it lacks any market power in the BPM Parcels market." Postal Service Response to ChIR No. 4, Question 3a. The Postal Service argues that the existence of several "competitors" that it identifies "establishes that the Postal Service lacks monopoly power in the BPM Parcels market." *Id*. Likewise, the Postal Service chooses to frame the issue as to whether it has "monopoly power." *See* Request at 10. This argument fails because the statutory test unambiguously refers to market power, not monopoly power, and while the two tests are related, they are not the same.

The statute defines market power as the power to raise prices substantially, set prices substantially above costs, or to limit output, without risk of losing a significant level of business to other firms offering similar products. *See* 39 U.S.C. § 3642(b)(1); *see also* 39 C.F.R. § 3040.132(d). Monopoly power is "the power to control prices or exclude competition." *United States v. E. I. du Pont de Nemours & Co.* (*Cellophane)*, 351 U.S. 377, 391 (1956). The Supreme Court has confirmed that, as the definitions suggest, "[m]onopoly power under § 2 requires, of course, something greater than market power under § 1." *Eastman Kodak Co. v. Image Technical Servs.*, Inc., 504 U.S. 451, 481 (1992). The Postal Service's attempt to explain away its admission of market power by asserting that it does not have monopoly power, which is a higher test, is unavailing under the statutory language. The Postal Service's admission that it has market power in the BPM parcels market is alone enough to require that the product transfer request be denied.

2. <u>The Postal Service exercises market power over BPM Parcels</u>

Even apart from the Postal Service's concession, the test for market power codified in Section 3642(b)(1) -- as the power to raise prices substantially, set prices substantially above costs, or to limit output, without risk of losing a significant level of business to other firms offering similar products --

is easily met in this case. *See* 39 U.S.C. § 3642(b)(1). The Commission has previously recognized that the statutory market power test codifies the customary test for market power -- whether a firm unconstrained by maximum rate regulation can increase profits through a small but significant non-transitory increase in price ("SSNIP"). *See* Docket No. MC2012-14, Order No. 1448 (Aug. 23, 2012) at 24-25 (quoting Department of Justice/Federal Trade Commission *Horizontal Merger Guidelines* establishing the test). *See also CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001) (citing the *Merger Guidelines,* judicial precedent, and antitrust treatises in noting that an "accepted method of measuring market power" is assessing whether a firm can raise its prices without a net loss of revenue, and holding that a 20% increase is "well above the standard usually employed to signal a substantial degree of market power," citing the Merger Guidelines' use of a "5% price-increase test" and a leading treatise's suggestion of a "5% or 10% differential"). If such a price increase would increase the firm's profits, the firm has market power.

The Commission has held that "Section 3642(b)(1) is intended to prevent the transfer of market dominant products to the competitive product list if the Postal Service enjoys such market power that it could raise rates or reduce service to the detriment of consumers without significant consequences, as defined." Order No. 689 at 14. As applied to the present case, these standards require the Postal Service to show that significantly raising the price of BPM Parcels, including educational multi-component BPM bundles, would result in volume losses of BPM Parcel volumes to other firms offering competitive products sufficient to cause a decline in the Postal Service's net contribution. Stated otherwise, if the Postal Service has sufficient market power to significantly raise prices on BPM parcels and increase its profits, it has market power and the transfer request must be denied.

In this case, the Postal Service has requested a conditional approval of its transfer request so direct evidence of the effects of a significant price increase on BPM Parcels is not available. Accordingly, the Commission must look to evidence of the Postal Service's projected impacts of price increases, pricing behavior with comparable products, and to structural evidence of market power and competition in relevant markets from "other firms offering similar products." 39 U.S.C. § 3642(b)(1).

3. <u>The Postal Service's own analysis confirms it has market power</u>

[redacted]

[redacted]

[redacted]

4. Prior experience with Standard Mail Parcels, a product with similar characteristics and pricing, confirms that the Postal Service has market power

The Postal Service's pricing behavior after Standard Mail Parcels were transferred from the market dominant to the competitive product list in 2012 confirms the Postal Service's market power over a similar inexpensive, lightweight, destination-entered, ground delivery product. The Standard Mail Parcel (now called Parcel Select Lightweight) transfer case and subsequent pricing experience is illustrative for many reasons.

At the time of Standard Mail Parcels transfer case the average inflation-adjusted price for lightweight Commercial Standard Parcels was effectively equivalent to the current average postage for BPM Parcels.[2] Then as now, the Postal Service argued that it did not exercise sufficient market power to allow it to raise prices significantly or raise prices above costs, without risk of losing a significant level of business to other firms offering similar products. *See* Docket No. MC2010-36, Request of the United States Postal Service to Transfer Commercial Standard Mail Parcels to the Competitive Product List (Aug. 16, 2010)(MC2010-36 Request), at 4. Then as now, the Postal Service argued that

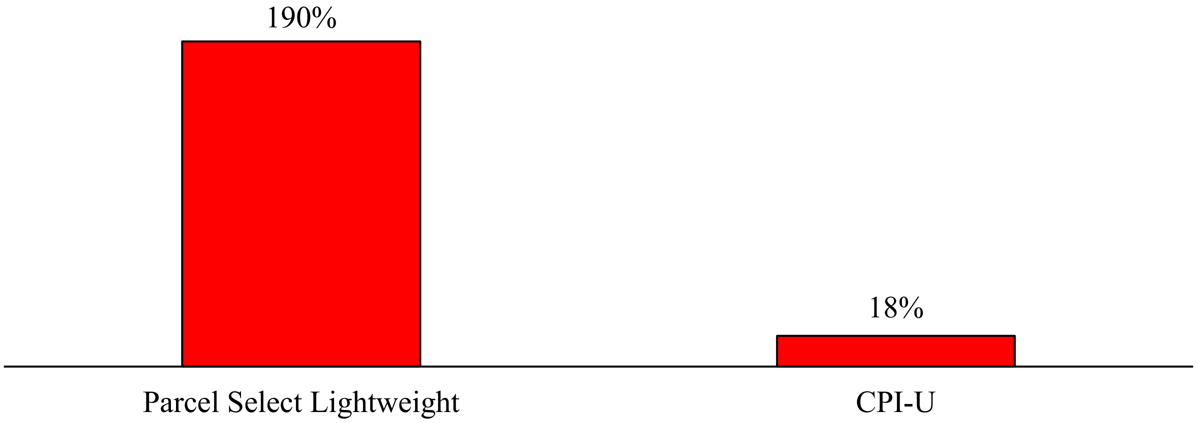
[2] Calculated by taking the average revenue per piece $0.887 in FY 2011 of Standard Mail Parcels (Docket No. ACR2011, USPS-FY11-1, FY11PublicCRA.xls, worksheet "Cost1", cell L30) and inflating to FY 2020 dollars using data from U.S. Bureau of Labor Statistics (https://www.bls.gov/data).

anachronistic distinctions were inconsistent with its vision of a "seamless" parcel shipping marketplace. *Id*. Then as now, the Postal Service contended that any pricing power was "illusory" because of cost coverage issues and that once it raised prices to full cost coverage levels, market shares of its competitors would "likely increase." *Id*., at 7. The Postal Service argued it was "unlikely that the Postal Service can set the price of commercial Standard Mail Parcels substantially above costs or raise prices significantly without losing a significant level of business to other firms." *Id*. The Postal Service held out UPS and FedEx Ground shipping services as substitute products, despite the fact that UPS and FedEx Ground products were in comparative terms feature-rich, superior products that were commanding substantial price premiums relative to Commercial Standard Mail Parcels then, and BPM Parcels now.

Not all parties were convinced. The Parcel Shippers Association (PSA) urged the Commission to deny the transfer request. *See* Docket No. MC2010-36, Parcel Shippers Association Comments (Sep. 24, 2010)(PSA Comments). In comments that proved prophetic, PSA argued that the Postal Service's market definition (ground shipping) was overbroad and that the Postal Service had failed to prove that private carriers would provide effective competition for Commercial Standard Mail Parcels. *See id*., at 6-11. PSA warned that the transfer would result in "massive price increases." *Id*., at 2.

With the benefit of hindsight, it is clear that Commercial Standard Mail Parcels should not have been transferred. All evidence confirms that the Postal Service had, and has, market power as defined by Section 3642(b)(1), over lightweight, destination-entered, ground delivery parcels. In the ten years since the product transfer the Postal Service has raised its prices on Parcel Select Lightweight by an average of 11 percent per year, or nearly 200 percent overall, substantially in excess of its costs. Figure A compares the cumulative price increases as compared to inflation.

Figure A – Parcel Select Lightweight Price Increase Since Product Transfer in FY 2012



Source: Docket No. MC2021-78, Responses of the United States Postal Service to Questions 1 - 3a and 4b of Chairman's Information Request No. 2 (April 22, 2021), Response to 1d; U.S. Bureau of Labor Statistics. (Note: Assumed 2% inflation rate for FY 2021.)

The actual experience of Parcel Select Lightweight also proves that the Postal Service had and has sufficient market power to raise prices substantially without fear of losing a significant level of business to other firms offering similar products. Notwithstanding a cumulative 200 percent price increase since the transfer, Figure B shows the corresponding volume growth over the same period.

Figure B – Parcel Select Lightweight Volume (in Millions)

[REDACTED]

[redacted]

The actual history also proves the Postal Service's theory that any pricing power was "illusory" because of cost coverage issues at the time of the transfer was plainly wrong. This is relevant to the BPM transfer request because the Postal Service is making the very same argument in this case citing the Standard Mail Parcel transfer case. *See* Postal Service Responses to ChIR No. 2, Question 3.a. Figure C depicts Parcel Select Lightweight cost coverage since the transfer. Figure C clearly shows that the Postal Service's market power has not abated as margins have increased.

Figure C – Parcel Select Lightweight Cost Coverage

[REDACTED]

[redacted]

The 20 percent price increase in the last competitive product price adjustment demonstrates the Postal Service believes it can continue to raise prices without fear of losing profits. Stated otherwise, the Postal Service's historic and current pricing behavior with respect to Parcel Select Lightweight Parcels confirm it has market power sufficient to set prices substantially above costs without risk of losing business to other firms offering similar products.

Again, this history is relevant here given the similarity in product characteristics and price between Parcel Select Lightweight Parcels and BPM Parcels. The history is also directly relevant because the provisional nature of this transfer request does not allow the Commission to assess direct evidence a pricing proposal for BPM Parcels as a competitive product. It is reasonable for the Commission to conclude that if the Postal Service continues to impose price increases substantially above costs on Parcel Select Lightweight parcels that it will do the same to BPM Parcels once transferred. The fact that the Postal Service could impose price increases substantially above costs on BPM Parcels confirms that the Postal Service has market power and, thus, the transfer request must be denied.

B. The Postal Service Has Failed to Prove There is Effective Competition for BPM Parcels

1. <u>The Postal Service's definition of the relevant market is overbroad and contrary to the unambiguous language of Section 3642</u>

The Petition contains a lengthy discussion regarding the unique regulatory history of BPM Parcels, the allegedly anachronistic nature of the product, and the supposedly arbitrary distinctions in what can be shipped under the BPM Parcel rate. *Petition*, at 2-4, 19. Even if the assertions were true, they are irrelevant to the statutory market power test in Section 3642.

The Postal Service's argument that these products happened to end up on the market dominant products list is incorrect; Congress expressly codified the product lists in enacting Sections 3621 and 3631. *See* 39 U.S.C. §§ 3621 and 3631. Nor is it accurate to suggest that Congress' interest in the issue was fleeting, as evidenced by the recent bi-partisan, bi-cameral expressions of concern regarding the Postal Service's plans to file a request to transfer BPM Parcels to the competitive products list. *See* Motion of Scholastic Inc. for Issuance of Information Request (Apr. 9, 2021), Questions 10 and 11. Congress' interest in the important role affordable postal delivery services can play in the distribution of educational, cultural, scientific, and informational content is evidenced in the language of title 39. *See* 39 U.S.C. § 3622(c)(11).

Furthermore, Congress was cognizant of the regulatory history when it codified the then existing product lists into market dominant and competitive products and enacted Section 3642. The statutory test for market power in Section 3642 does not turn on how the Postal Service views the parcel delivery market - a box is a box is a box. Rather, the statutory test seeks to protect shippers and users of products historically classified as market dominant products and tries to assess how they will be affected if the product is transferred to the competitive products list and rate regulation protections are removed. Viewed through the lens of the plain language of Section 3642(b)(2) it is clear that the transfer of BPM Parcels would invite precisely the harm to users of that product that Congress sought to protect against.

The Commission has held that "[i]t is apparent that service providers offer a variety of products within the overall parcels market, and that these products address different segments of the overall parcels market. It is also apparent that all service providers do not compete equally within each market segment." Docket No. MC2015-7, Order 4009 at 11 (citing the *Merger Guidelines*). This means that "using the overall parcels market as the basis for evaluating market power may not produce meaningful results." *Id.* These findings are equally valid in this case. Indeed, as noted above the record evidence and applicable precedent demonstrate the existence of a unique market for BPM Parcels generally, and a market segment, or submarket, of educational multi-component bundle BPM Parcels.

2. Private Carriers Do Not Provide Effective Competition for BPM Parcels

The Postal Service identifies the ground service products offered by United Parcel Service (UPS) and FedEx Corporation (FedEx) as competitors of its BPM Parcels service, asserting that "[a]ny package a customer could send using BPM Parcels, it could, in the alternative, send as a UPS or FedEx Ground package." Request, at 6-7. The evidence the Request presents as to competition from private carriers is conclusory and unsupported. Indeed, the Postal Service concedes it has not undertaken any study or analysis of whether the BPM Parcel product meets the statutory definition of a market dominant product. *See* Postal Service Responses to ChIR No. 3, Question 9.

The Postal Service argues that BPM Parcels, an inexpensive non-guaranteed ground delivery product, are "in fact, interchangeable" with UPS and FedEx "Ground" services. *See* Request at 7. It acknowledges that the prices for UPS and FedEx Ground products are higher, *id*., though it does not acknowledge just how much higher -- and, in fact, the prices are substantially higher than BPM Parcels rates. As discussed below, UPS and FedEx Ground prices are more comparable, yet higher still, than the Postal Service's premium Priority Mail parcel product. The Postal Service waves this price differential off with the assertion that "the cost of the higher UPS and FedEx list prices pays, in part, for additional features not offered by BPM Parcels," *id.;* thus, arguing that any obvious asymmetry in pricing between alleged similar products should be overlooked because BPM Parcel shippers could pay more for a feature rich, superior product. This argument misconstrues the relevant analysis regarding substitutability. Substitutability is based on whether the customer can find a substitute that serves its need, not on the Postal Service's assertions as to what its customers should want. *See Arizona Public Service Co. v. United States*, 742 F.2d 644, 652-53 (D.C. Cir. 1984)(question is "whether differences in the price, type, grade or quality of two products cause *purchasers to see them* as not interchangeable")(emphasis added).

The Postal Service's statement that the UPS and Fed-Ex Ground products are "in fact, interchangeable" is also contradicted by its responses to the Chairman's information requests. The Postal Service was asked to confirm that, even assuming a market dominant system wide cost coverage of 155.9 percent for BPM Parcels, the hypothetical BPM Parcel average revenue per piece would still be lower than UPS and FedEx Ground published prices. *See* Postal Service Responses to ChIR No. 3, Question 5.c. The Postal Service declined to answer the question on the basis that comparing BPM Parcels and UPS and FedEx Ground products would be an "apples to oranges comparison" because "BPM Parcels is predominantly a last-mile delivery product. UPS Ground and FedEx Ground are not." Responses to ChIR No. 3, Question 5.c. The Postal Service does not explain how the UPS and FedEx Ground products can substitute for the BPM Parcel last mile product with products that are not themselves a last mile delivery product. Nor does it explain how products can be considered substitutes when they are in fact "apples and oranges."

The Postal Service also notes that UPS "retains some volume for its own last-mile network where it has sufficient delivery density." Request, at 12. This position contains its own rejoinder. Even assuming UPS could provide a competitive product where it has "sufficient delivery density," there are certainly areas where UPS does not. This distinction is of critical importance to Scholastic. The Scholastic Book Clubs reach over one million teachers and 26 million children each year. However, given the nature of Scholastic's educational mission, more than half of the BPM Parcels shipped by Scholastic are sent to educators and students in rural locations where access to affordable books is most challenging. Additionally, over one third of the schools Scholastic ships to are Title 1 schools that are especially sensitive to cost pressures. These are the very same geographical markets where it is least likely that private competitors will have sufficient delivery density to service as effective competitive alternatives.

Moreover, as discussed below, in response to the Postal Service's assertion that customers need not worry about price increases because they can protect themselves by building out their own logistics networks, antitrust courts correctly hold that even if there are some customers who might have suitable alternatives (where UPS or another carrier has "sufficient delivery density"), those customers who do not have those alternatives must be protected from the exercise of market power. *See* pp. 23-25, *infra* (discussing the *Cardinal Health* decision).

3. Price comparisons confirm that the Postal Service has market power as defined in Section 3642(b)(1)

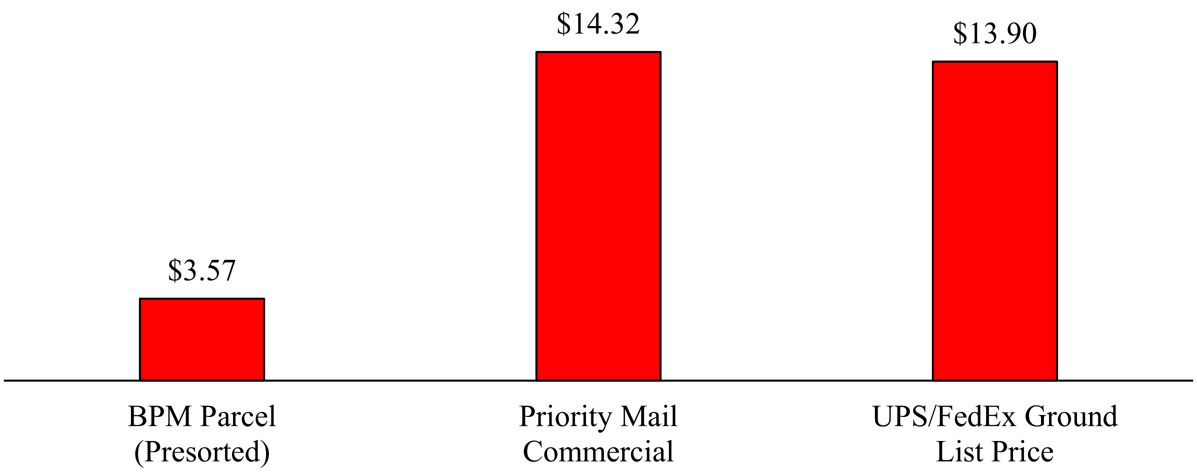
The Postal Service asserts without any evidence that the prices for UPS and FedEx Ground products "are at least comparable for the purpose of including [them] within the BPM Parcels market segment." Request, at 7. No further explanation is provided. A review of the Postal Service's own price comparison analysis as well as a comparison of published prices demonstrates that this statement is contrary to fact.

[redacted]

Price comparisons based on published prices confirm that UPS and FedEx Ground products are in a different market segment than BPM Parcels. Two different price comparisons, one for a typical BPM Parcel that Scholastic would use to fulfill a book order, and a second for a typical educational, multi-component bundle BPM Parcel that Scholastic would use to send its Book Club Kits, illustrate the point.

Figure D shows a price comparison for a typical 6-pound, Zone 5 Parcel, a typical weight and price profile for Scholastic book fulfillment orders.

Figure D – Comparison of Prices for a 6-Pound, Zone 5 Parcel



Source: United States Postal Service, Notice 123;
https://www.ups.com/assets/resources/media/en_US/daily_rates.pdf;
https://www.fedex.com/content/dam/fedex/us-united-states/services/FedEx_StandardListRates_2021.pdf.

For purposes of this example, the UPS and FedEx Ground prices do not include applicable Residential Surcharges ($4.35 – FedEx; $4.45 – UPS) or Delivery Area Surcharges ($4.30 – FedEx & UPS). As shown in Figure D, even excluding these surcharges, the UPS and FedEx Ground list price is nearly 300 percent higher than the BPM Parcel price. As above, the UPS and FedEx Ground list prices are comparable to the Priority Mail Commercial price. Additionally, Scholastic uses a consolidator to transport BPM Parcels to destination postal facilities, so the effective price differential for Scholastic between BPM Parcels and UPS and FedEx Ground products for a typical book order would be even starker.

Figure E shows a price comparison of prices for a 4-pound, Zone 1&2 Parcel, representing the typical weight an entry profile for a Scholastic Book Club Kit sent as an educational, multi-component bundle BPM Parcel. Figure E shows prices for a DNDC-Entered BPM Parcel, for Priority Mail, and for UPS and FedEx Ground.

Figure E – Comparison of Prices for a 4-Pound, Zones 1&2 Parcel

Source: United States Postal Service, Notice 123; https://www.ups.com/assets/resources/media/en_US/daily_rates.pdf; https://www.fedex.com/content/dam/fedex/us-united-states/services/FedEx_StandardListRates_2021.pdf.

As above, the UPS and FedEx Ground prices do not include applicable Residential Surcharges ($4.35 – FedEx; $4.45 – UPS) or Delivery Area Surcharges ($4.30 – FedEx & UPS). Even excluding these surcharges, the UPS and FedEx Ground list price is 455 percent higher than the BPM DNDC Parcel price. In this example, the UPS and FedEx Ground price is even higher than the Priority Mail Commercial price. Scholastic uses a printer and transportation company to enter its educational, multi-component bundles, but the processing and transportation charges do not materially affect the comparison.

The price comparisons conclusively establish that the Postal Service could substantially increase prices on BPM Parcels without risk of losing business to other firms offering similar products. There are no comparable products that can provide effective competition, thus, the Postal Service can freely exercise market power to raise prices.

The Postal Service's attempt to explain that the higher prices are due to delivery guarantees and a much higher weight limit merely confirms that the products are not interchangeable, "in fact" or otherwise. They are as noted above, simply different products -- "apples and oranges" in the Postal Service's words. The Postal Service also gains nothing by asserting that many commercial customers pay lower negotiated prices for UPS and FedEx Ground products. The presence of large competitors in market alone does not mean USPS does not have market power if there is no effective price competition for similar products. [redacted].

The evidence before the Commission confirms that these purported alternatives would be so costly to use that if BPM Parcels were transferred to the competitive product list the Postal Service could increase its prices well in excess of the standard benchmarks used to detect the presence of market power. Again, this conclusion alone requires denial of the transfer request.

4. The Postal Service's argument that consolidators "reselling" BPM Parcels serve as effective competition fails as a matter of law and fact.

The Postal Service's fall back argument that other companies that "resell BPM Parcel delivery to their customers and use the Postal Service for delivery by entering packages into the mailstream as BPM Parcels" provide effective competition that would constrain the Postal Service's restrain BPM pricing is fanciful. Request at 8. These companies are not offering competitive substitute products; they are selling the BPM Parcel product itself. If the BPM Parcel price is raised so too will the cost of any product that itself relies on that service, and customers will not be able to avoid or constrain that price increase.

The language of Section 3642 itself recognizes this common sense outcome by requiring the competition to be assessed in determining the Postal Service's market power relative to "other firms offering similar products." The Postal Service's argument that "resellers" of its own BPM Parcels product provide effective competition, fails on both prongs of this test. Only another firm can compete with the Postal Service -- it cannot compete with itself. *See*, *e.g*., 8 Areeda and Hovenkamp, *Antitrust Law* ¶ 1470 (3d ed. 2010); *Copperweld Corp. v. Independence Tube Corp*., 467 U.S. 752 (1984). Resellers cannot provide effective price competition because they are selling the same Postal Service product even if they bundle it with a service of their own -- there is no "other firm" and no "similar product." There are only different parties selling the same BPM Parcels product. The Postal Service remains free to set the price of that product that the resellers must take, and they cannot offer a competitive alternative that would constrain the Postal Service's pricing.

To the extent the Postal Service is arguing that UPS and FedEx can keep BPM Parcels in their networks for final mile delivery, the UPS and FedEx products are different products as discussed above. To the extent they or others enter the package into the Postal Service network, or like DHL and OSM, do not have final mile delivery capability, they are not competitors at all. Whatever valuable services the resellers provide, they do not offer a competitive product and cannot constrain the Postal Service's pricing. *See* Postal Service Response to ChIR No. 4, Question 3.

5. <u>The suggestion that BPM Parcel shippers use Media Mail is unavailing</u>

The Postal Service's suggestion that its Media Mail product can serve as a substitute product for BPM Parcels also fails. *See* Request, at 15. For reasons sated above, Media Mail cannot serve as a substitute product under Section 3642(b)(1) because it is not a similar product offered by another firm; again, the Postal Service cannot compete with itself.

Furthermore, the use of Media Mail would impose an immediate increase of more than 80 percent over what Scholastic currently pays for delivery of its books. The suggestion not only demonstrates the cavalier attitude the Postal Service brings to imposing very large price increases on its customers, it also demonstrates the pricing power that the Postal Service would have over customers such as Scholastic were it freed from the pricing constraints applicable to Market Dominant products. The price differential reflects the fact that Media Mail does not provide zone-based pricing, but the impact on Scholastic and other shippers would be the same. The fact that Media Mail is origin point only means that shippers would be forced for pay more for slower service expectations.

The Postal Service's suggestion also ignores the fact that BPM Parcels cost coverage for FY 2020 is 94 percent, with a negative 7.3-cent unit contribution, whereas Media/Library Mail had a 79.3 percent cost coverage and negative 93.3-cent unit contribution in FY 2020. *See* Docket No. ACR2020, USPS-FY20-1, Public_FY20CRAReport.Rev.2.22.21.xlsx, worksheet "Cost1," rows 43 and 44. FY 2020 was an unusual year due to the pandemic, in past years the cost coverage of BPM Parcels has been over 100 percent, and the cost coverage for Media Mail has historically been below BPM Parcels. Therefore, it is difficult to see how a shift in mail mix from BPM Parcels to Media Mail would benefit the Postal Service. In reality, if the Commission allowed the transfer of BPM Parcels despite the evidence of market power here, it would set a precedent for the future transfer of other products containing educational, cultural, scientific and informational content; thus, making any attempt by Scholastic to seek protection in the Media Mail category as an expensive, and likely temporary, refuge.

C. USPS' Argument that It Cannot Exercise of Market Power because BPM Parcels are "Substantially Underpriced" is Contrary to the Unambiguous Language of Section 3642

The Postal Service's argument that the statutory market power test does not apply to "*current* prices but rather from *competitive* prices" is contrary to the statute's plain language and would invert its purpose. Postal Service Responses to ChIR No. 2, Question 3a. The statutory language is specific and controlling. By its terms it applies to the prices at the time of the transfer request. It is not conditioned on prices first being raised to levels USPS considers competitive.

The logic of the Postal Service's argument would apply to all regulated Market Dominant products, effectively reading Section 3642(b)(1) out of the statute. Any Market Dominant product could be argued to be "underpriced," even if it was covering it costs, and subject to substantial price increases above costs on that basis. This outcome is, however, precisely what Section 3642(b)(1) prevents by its terms. The outcome is also inconsistent with the principle that regulated rates are intended to "simulate what [the regulated entity's] economic behavior would be in a competitive market." *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 961 (D.C. Cir. 2007).

Nor may the statutory market power test be disregarded on the theory that the current or starting prices for BPM Parcels are noncompensatory. The Postal Service misreads the Commission's prior commentary as adopting a "standard" that would directly conflict with the plain language of Section 3642(b)(1) and the Commission's implementing regulations. Postal Service Responses to ChIR No. 2, Question 3a (citing Docket No. MC2010-36, Order No. 689 at 16); *compare* 39 U.S.C. § 3642(b)(1) and 39 C.F.R. § 3040.132(d)(1-4). Given the actual pricing experience with the transfer of Standard Mail Parcels discussed above, it is clear in retrospect that the Postal Service did and does exercise market power with respect to lightweight, destination-entry ground parcels such that it has and continues to profitably increase prices substantially above product costs without losing business to other firms offering similar products. The Commission should avoid making the same mistake with BPM Parcels.

The Postal Service has acknowledged that the current list price for UPS and FedEx Ground is 455 percent higher than the current list price for a 4 pound, Zone 1&2 DNDC BPM Parcel. *See* Postal Service Responses to ChIR No. 1, Question 12.a. The Postal Service has further acknowledged that the estimated cost coverage for BPM Parcels after a 455 percent price increase would be 520.6 percent assuming constant unit costs. *See* Responses to ChIR No. 1, Question 12.b. Stated otherwise, the Postal Service is arguing that the statutory market power test would not be relevant until it had imposed price increases of 455 percent and obtained a supracompetitive margin of over 400 percent on BPM Parcels. This is contrary not only to the statutory language but to the basic concept of market power.

D. The Postal Service Provides No Evidence to Support the Transfer of Educational Multi-Component Bundle BPM Parcels

1. Even if the Postal Service could not exercise market power over the delivery of BPM Parcels as a whole, the statute recognizes the possibility of different sub-markets for different products, and educational multi-component BPM bundles are a submarket over which the Postal Service would exercise market power.

Section 3642(c) expressly permits the transfer of only part of a product. *See* 39 U.S.C. § 3642(c). Market power over a sub-market is thus sufficient to deny a transfer as to the products in that sub-market. Here too the plain language of the statute and the Commission's precedent are also supported by antitrust case law and the practice of the antitrust enforcement agencies. In reviewing mergers, for example, the agencies will often look to see if there are customers or groups of customers who would not be able to switch to a competing supplier in the event of a price increase, even if some customers were able to. In *FTC v. Cardinal Health*, 12 F. Supp. 2d 34 (D.D.C. 1998), for example, the agency adopted a narrow definition of a market for the wholesale distribution of prescription drugs, even though for some customers self-supplied warehousing and distribution was an alternative. The court noted that other classes of customers, "namely hospitals and independent pharmacies, would have no reasonable substitutes," and thus adopted the narrow definition advanced by the agency. *Id*. at 47.

As discussed above, the Postal Service argues that it does not exercise "monopoly power" over BPM Parcels because much of its BPM Parcels volume originates from logistics entities with their own origin-through-last-mile delivery networks, and that these logistics entities and other large customers would be able to respond to a price increase by diverting volume to their own networks, or by threatening to do so to obtain negotiating power over the Postal Service. *See* Request, at 10-14. Again, the relevant test is market power, not monopoly power, and the Postal Service is simply arguing the wrong standard. Moreover, the Postal Service's argument fails in any event just as the similar argument failed in *Cardinal Health*. The fact that large companies or logistics entities may be able to protect themselves from the Postal Service's exercise of market power is of no consolation to entities that cannot, such as Scholastic. This, again, is itself enough to deny the Petition as to educational multi-component bundle BPM Parcels even if it could be granted as to other products.

Courts have recognized distinct submarkets based on consideration of "such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *See Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). *See FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1075 (D.D.C. 1997) ("The [Federal Trade] Commission discussed several of the *Brown Shoe* 'practical indicia' in its case, such as industry recognition, and the special characteristics of superstores which make them different from other sellers of office supplies, including distinct formats, customers, and prices."). The Postal Service recognizes that the Commission follows "[f]ederal antitrust principles and guidelines" and that "identifying the market in which a product competes may also mean identifying the relevant segment of a larger market." Request, at 6 (citing Order No. 2306 at 18, which adopts the "reasonably interchangeable" standard of *Cellophane*.) "Also relevant are public perceptions of markets or a firm's perception of who its competitors are and of whether the products are acceptable substitutes for one another." Order No. 2306 at 16.

The customer base for Scholastic's product utilizing the USPS postal network is exclusively education and literacy driven, targeting educators, students and their parents. The current structure of BPM rates allows Scholastic to promote books at affordable rates, as low as $1 books, so that even students and families in economically challenged situations can purchase books. As the hundreds of comments in the record from teachers and school administrators attest, dramatic postal rate price increases would significantly impair Scholastic's ability to promote such affordable books to these low-income communities. Scholastic primarily promotes books through multi-component shrink-wrapped BPM Parcels, combining up to three different grade-leveled student flyers for multiple teachers at a school address. Scholastic addresses the educational market only with this customized product and, with the exception of a small percentage of homeschool teachers and other pandemic-related workarounds, does not market to residential addresses.

These "practical indicia" readily establish that educational multi-component bundle BPM Parcels is a submarket, and as a relevant segment of the larger BPM Parcels market is entitled to protection from the exercise of market power. As set forth more fully below, Scholastic has no reasonable alternatives to reach this unique and highly price sensitive customer base with its unique product. No distribution channel besides the Postal Service will accept these non-containerized, multi-component bundle BPM Parcels. The transfer should thus be denied as to this segment even if it permitted as to the broader BPM Parcel market.

2. <u>Transfer of Educational, Multi-Component Bundle BPM Parcels is unsupported</u>

As set out above, educational multi-component bundle BPM Parcels are a relevant submarket and market segment for purposes of assessing the Postal Service's transfer request and its market power. The Postal Service concedes that it has not performed any studies or analysis to assess whether it has market power over this submarket. *See* Postal Service Responses to ChIR No. 1, Question 3. It further concedes that it is not aware of any other firm offering delivery services for educational multi-component bundles. *See* Responses to ChIR No. 1, Question 4. In fact, there are none. Other private competitors will not accept, process or deliver non-containerized, educational multi-component bundles.

The Postal Service also concedes it has not undertaken any studies or analysis to determine the costs that a mailer would incur if forced to shift preparation of educational multi-component bundles into containerized boxes. *See* Responses to ChIR No. 1, Question 5. In fact, those costs would be substantial. Scholastic estimates that if it were forced to carton all of its educational multi-component bundles it would incur substantial costs in addition to having to pay higher UPS and FedEx Ground prices. Indeed, the costs of changes in operations and mail preparation could equal or exceed the costs of the postage increase itself. For example, the costs of the boxes alone for the over 2 million bundles

Scholastic ships each year would be in the range of $5 million. Lead times for shipments would also change, potentially affecting the entire logistics chain.

By the same token, the Postal Service concedes it has not undertaken any studies or analysis to assess the views of users who mail educational multi-component bundles on the appropriateness of the requested transfer of educational multi-component bundles from the Market Dominant to the competitive product list. *See* Responses to ChIR No. 1, Question 6. The comments filed in this docket give a sense of the strong opposition from teachers and school administrators who use Scholastic's educational multi-component bundles.

The Postal Service also concedes it has not undertaken any studies or analysis to assess the likely impact of transferring educational multi-component bundles from the market dominant to competitive product list on small businesses. *See* Responses to ChIR No. 1, Question 7.

In contrast to the Postal Service, which handles a substantial volume of shrink-wrapped bundled mail and parcels, UPS and FedEx Ground do not offer a non-containerized, multi-component bundle product. Accordingly, to use UPS or FedEx Ground as an alternative would also require Scholastic to change its operations to place its educational multi-component bundles in a sealed carton. In sum, the Postal Service's contention that the UPS and Fed-Ex Ground products provide reasonable alternatives to this submarket of BPM Parcels product that would constrain the Postal Service from increasing the prices if the transfer request were approved is incorrect.

3. <u>Educational, multi-component bundle BPM Parcels are appropriately considered a subclass or subordinate unit within the meaning of Section 3642(c)</u>

Section 3642(c) permits the transfer of only part of a product and expressly contemplates distinctions between relevant "subclasses or other subordinate units of a class of mail or type of postal service involved (without regard to satisfaction of minimum quantity requirements standing alone). *See* 39 U.S.C. § 3642(c). The Postal Service's Request and the evidence in this case clearly establish that the Postal Service's view of the BPM Parcels market as monolithic is unsupportable.

Because it cannot deny that Section 3642(c) expressly allows the transfer of only part of a product, the Postal Service's argues instead that educational content multi-component bundles could not be a stand-alone product under Section 102(6). *See* Responses to ChIR No. 1, Question 10. This formalistic argument is not well taken. Section 102(6) of the Act defines a product to encompass any "postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be applied." 39 U.S.C. § 102(6). The Commission has repeatedly recognized that the product definition is flexible, going so far as to note that "almost any category of mail would qualify." Docket No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology (Sept. 14, 2010), at 22. The product definition is easily flexible enough to encompass educational multi-component bundles as a stand-alone product.

The Postal Service has not cited, and Scholastic is not aware, of any case where a product properly defined as a market segment or as a submarket has nonetheless been held not to meet the statutory definition of a stand-alone product. Such a result would be highly anomalous given the similarity between the market segment and submarket inquiries and the statutory definition ("distinct cost or market characteristic"). The Commission has stated that when determining whether a proposal constitutes a product it "must consider the context." Docket No. MC2012-26, Order No. 1657, Order on Elective Filing Regarding Post Office Box Service Enhancements (Feb. 14, 2013), at 17. The context here dictates that educational multi-component bundles are a product under Section 102(a).

Sound policy also weighs in favor of excluding educational multi-component bundles from the transfer request. The comments of record show that these bundles are a price-sensitive means to deliver educational materials to schools, many that have high proportions of students of modest means. Protecting this market segment from a very significant price increase will further this educational mission and is consistent with the unique status afforded educational, cultural, scientific, and informational content in the postal laws of the United States.

III. CONCLUSION

For the reasons stated above, the Postal Service's product transfer request should be denied. If the Commission determines to approve the BPM Parcel transfer in part it should excluded educational multi-component bundles.

Respectfully submitted:

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